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# Selected problems and development prospects of local government units' accounting

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## **Abstract:**

**Aim:** The accounting of local self-government units in its current state does not correspond to the requirements of modern management in the public sector. The paper shows the specific features of budgetary accounting of local self-government units, its basic problems and its future solutions related to the new challenges faced by LGU management, e.g.: shifting away from the dominance of the cash accounting method under the EU budgetary accounting standardization, securing consistency and comparability of budget reporting, increasing the effectiveness of supervision and control in budgetary accounting and the development of activity-based accounting.

**Research methods:** In the paper, the following research methods were applied: a review of literature concerned with budgetary accounting and public finance, an analysis of legal acts, comparative and descriptive analyses.

**Findings:** In its present state the LGU accounting system is not efficient and it will fail to be a suitable source of information for modern management of public sector entities unless the cash principle is supplanted by the accrual principle, as part of the implementation of EPSAS, and budget reporting is properly harmonized, simplified and unified. In order to provide the necessary information for the implementation of activity-based budgeting in LGUs, one needs to combine skillfully the methods and techniques derived from ABC and management accounting, which will allow task-based accounting to search for and apply various solutions in accounting records.

**Originality / value of the paper:** This paper summarizes the most up-to-date accounting problems faced by LGUs while showing both theoretical and practical ways of solving them. In the author's opinion, this work can be a useful tool for accounting practitioners and a contribution to further academic exploration.

**Research implications:** The paper can have a significant impact on the practice of budget accounting in local self-government units in Poland.

**Keywords:** accounting, finance, reporting, local self-government unit, public sector.

**JEL:** M41.

## 1. Introduction

Information function consisting in delivering appropriate information to recipients is among the basic functions of accounting. The accounting of local self-government units (LGUs) is characterized by a considerable variety of the recipients of the information from LGU executive boards, to founding, control and supervisory bodies and finally to representatives of local communities. What also makes this accounting stand out is the specific nature of the economic information (that is collected, processed and presented) on budgetary revenues and expenditures, budget outturn, the state and changes unfolding in the course of current operations in terms of assets (including, e.g. money held in bank accounts) and their source.

The aim of the paper is to outline the specific features of LGU budgetary accounting, showing its basic problems as well as directions for further development in connection with the new challenges faced by LGU management. In order to accomplish this objective, the following research methods were used: a review of literature concerned with budgetary accounting and public finance, an analysis of legal acts as well as comparative and descriptive analysis.

## 2. General characteristics of local self-government units' accounting

As noted in the introduction, LGU accounting, being a subsystem of budgetary accounting on a par with the state budget accounting, features a range of specific characteristics linked to the specificity associated with the way public finance operates. Table 1 shows basic differences between the public sector finance – LGU finances, and those in the private sector – commercial enterprise finances.

**Table 1. Basic differences between LGU finances and commercial enterprise finances**

Comparison area	LGU finances	Commercial enterprise finances
Relationships between entities	dependency and subordination	equivalence of entities
It is affected by	political reality	market mechanisms
The purpose	to fulfill collective needs of specific (local) social groups	maximize profits
The principle of the management of	the principle of openness in managing	the principle of discretion in

funds	public funds	the management of undertaking's own funds
The basic indicator of the task implementation	full implementation of a task without overrunning expenditures which were previously planned in the budget	financial liquidity and profit

Source: self-reported data.

Table 1 presents only those areas of comparison which were chosen given the topic of the paper, and hence does not cover all the aspects of financial functioning. Still, it provides a sufficient basis to see clearly diametrical differences between the functioning of LGU finances and those of business entities: different relationships between entities, different mechanisms of development, different goals and management principles, and different indicators for the implementation of planned objectives. This differentiation had to be reflected in the principles, methods and ways of keeping accounts in the public finance sphere and commercial sphere. Essentially, budgetary accounting creates information that is necessary for public property to be safeguarded and controlled and to make those managing this property accountable to the public. There is no doubt that the scope of accountability is completely different in the accounting of commercial enterprises – in general, it is the person managing private property that is held accountable to the owner. Table 2 compares the financial accounting of commercial enterprises with the budgetary accounting of local self-government units.

**Table 2. Comparing commercial enterprises' accounting with LGU budgetary accounting**

Selected areas of comparison	Financial accounting of commercial enterprises	LGU budgetary accounting
Legal basis	Accounting Act <sup>1</sup> (UoR) IAS	UoR, Public Finance Act <sup>2</sup> (UoFP) and its implementing acts (relevant Regulation of the Minister of Finance on, e.g. specific rules on accounting, chart of accounts <sup>3</sup> and LGU reporting <sup>4</sup> IPSAS.

<sup>1</sup> Accounting Act of 29 September 1994, consolidated text, J.L. 2018, item 395, as amended.

<sup>2</sup> Public Finance Act of 27 August, consolidated text, J.L.. 2017 item 2077, as amended.

<sup>3</sup> Regulation of 13 September 2017 of the Minister of Finance on accounting and charts of accounts for the state budget, budgets of local self-government units, budget units, self-governing budget establishments, state earmarked funds and state budgetary units based outside the Republic of Poland, consolidated text, J.L. 2017, item 1911.

<sup>4</sup> Regulation of 9 January 2018 of the Minister of Development and Finance on budgetary reporting, consolidated text, J.L. 2018, item 109, as amended.

SELECTED PROBLEMS AND DEVELOPMENT PROSPECTS OF LOCAL GOVERNMENT UNITS' ACCOUNTING

Material scope of accounting	All economic operations recorded in accounting books which take place in an organizational unit of the enterprise (referring, e.g. to items of fixed and current assets, the source of these assets, revenues and expenditures, settlements and performance).	a) LGU budget implementation accounting: recording the process of raising and spending budget cash, together with determining the budget outturn seen as surplus or deficit;  b) Accounting of budgetary units and budgetary establishments: records of cash being raised and spent; the physical items of fixed and current assets, revenues and costs, settlements and performance;  c) Tax and fee accounting: keeping records and accounting for taxes and fees owed to the LGU budget.
Accounting principles	Accrual principle (coupled with occasional use of the cash principle – e.g. in the cash flow statement).	Modified cash principle (referring to budget implementation, i.e. budget income and expenditure records) and the accrual principle for recording other operations, e.g. for records in budget establishments.
Financial year	The entity can be flexible when it comes to choosing the financial year, the entity can take into consideration the specific features of its operations: apart from the calendar year, there can be another period of 12 calendar months used also for tax purposes.	It is not possible for LGU to set independently this year; it is equivalent with the budget year, i.e. calendar year.
Reporting period	Every period for which a reporting is drawn up based on the accounting books (a month, quarter, year).	Clearly defined as a month.
Chart of accounts	There is no official template for the chart of accounts, they are set according to the entity's needs.	It is based on a model (obligatory) chart of accounts, according to the relevant regulation of the Minister of Finance, which has to include the budget classification.
Method of keeping accounting books	By the enterprise itself or the books are entrusted to a Polish entrepreneur providing book keeping services or an entrepreneur running this kind of business from another EU Member State.	By the LGU itself or the book keeping is entrusted to another unit of the public finance sector, according to the rules laid down under separate regulations.
Events recognized in the accounting	<i>Ex post</i>	<i>Ex post</i> and <i>ex ante</i> in special off-balance sheet accounts.
The way of recognizing fixed assets and intangible assets (including: definition,	According to UoR.	According to a separate regulation on special rules of LGU budget accounting.

depreciation, amortization).		
Rules on valuation of assets and liabilities.	According to UoR	Separate valuation rules.
Inventory	According to UoR	Separate inventory rules.
The method for determining the financial result.	To be selected from the following: multiple-step or comparative variant.	Only comparative variant.
Reporting	According to UoR.	Separate budgetary reporting (it is not subject to UoR).
Control	-Internal control (carried out on its own and in the manner set by the company's director),  -External (carried out by a tax office, and for entities designated in UoR by an audit firm.	-Internal (carried out by the unit's head),  -Internal audit (required in LGUs set out in UoFP),  - Management control (in all LGUs),  -External (carried out by the following bodies: Regional Audit Chambers (RIO), the Supreme Audit Office (NIK), Voivode, tax office, external audit firm (on commission).
Supervision	Private, ownership.	RIO, NIK, Voivode and the Prime Minister.

Source: self-reported data.

Based on the data from Table 2, we can see considerably more elaborate legal regulations governing the LGU budgetary accounting compared to financial accounting: apart from the general accounting principles included in UoR, what also applies to LGU accounting is UoFP (including its implementing acts) and specific rules laid down in the relevant regulations of the Finance Minister. This is the reason why there exist different rules on valuation of assets and liabilities in LGUs compared to commercial entities, a different method of recognizing fixed assets, intangible assets and of keeping inventory. Budgetary reporting is characterized by being entirely separate and not subject to the provisions contained in UoR.<sup>5</sup> Compared to commercial enterprises, local self-government units are subject to much stricter accounting regulation: they have, inter alia, no discretion in setting the financial year, reporting periods, they cannot select

<sup>5</sup> In the Framework of the budget system reform," the Ministry of Finance plans to "harmonize the rules on accounting and public finance both as regards the definition of the basic concepts (e.g. expenditure and income, investment and fixed assets), as well as the method of preparing financial reports or accounting for long-term liabilities (e.g. those relating to pension or remuneration payments) and their presentation" (the Ministry of Finance, 2016: 44).

the method for determining the financial result, and while building the charts of accounts, they have to use the model taken from the relevant regulation by the Minister of Finance, also taking into account the budgetary classification. The material scope of the LGU budgetary accounting is considerably broader than in a commercial enterprise, encompassing not only accounting for economic operations, items of assets, their sources and performance (e.g. in self-governing budget establishments), but also separate accounting for the processes of raising and spending cash from the budget, while assessing the budget outturn as a surplus or deficit (LGU budget implementation accounting). Such a broad scope of LGU budgetary accounting is brought about by the multiple functions which LGUs have to fulfill: e.g. a commune is a budgetary unit while simultaneously it is also a financial and tax authority in relation to taxes and local fees. In the LGU accounting, the modified cash principle is prevalent unlike the finance accounting of commercial enterprises, where the accrual principle is employed. In terms of control, one can find that LGUs have a significantly more extensive and regulated system of internal control. It consists of internal control, external audit, management control, also being subject to tighter control and supervision by a larger number of authorities conducting external control than is the case in commercial enterprises. The general conclusion can, therefore, be that in comparison with the financial accounting applied in commercial entities, the LGU accounting is more complicated, and hence it has more problems that need to be solved, as will be presented in Chapter 3.

### **3. Selected aspects of local self-government unit accounting**

Among the issues of LGU budgetary accounting, those were selected which, in the author's view, have existed for a long time (for several up to dozens of years), yet need to be solved fast, considering the urgency for improving public finance management. These problems are as follows: shifting away from the dominant cash method under the standardization of budgetary accounting of the EU countries, securing consistency and comparability of budgetary reporting, maintaining balance in terms of control and supervision in the public finance sector and developing task-based accounting.

### 3.1. Cash method and budgetary reporting standardization

As already noted in Table 2, the dominant method in LGU budget accounting is the cash method, according to which “revenues and expenditures are recognized at the time of their payment, irrespective of the annual budget they refer to.” (UoFP Article 40 (2) point 1), with the following exceptions to this rule: a portion of income taxes transferred by tax offices in January of the following year and classified as the LGU revenues of the previous year, and the salaries of some professional groups for the month of January but paid in advance in December. The remainder of the operations in LGUs and all the operations in the private sector are accounted for according to the accrual principle, according to which “All income earned by an entity and all related costs which refer to a given financial year must be recognized in the entity’s books of accounts, irrespective of the date of their payment.” (UoR, Article 6 (1)). The authors of the *Guide to the new system of EU financial reporting, EU’s new accounting system. More effective management, greater transparency*” define accrual-based accounting as “an accounting system under which events are accounted for which form the basis for cash flow, and not the cash flow itself” (*EU’s new accounting system*, 2008: 9). Either of these principles has its advantages and disadvantages, as shown in Table 3.

**Table 3. Advantages and disadvantages of cash and accrual methods**

Method	Advantages	Disadvantages
Cash	<ul style="list-style-type: none"> <li>- it is consistent and easily accessible;</li> <li>- coherent with a cash-based way of budgeting;</li> <li>- it is suitable for preparing current information on the budget implementation and for observing budgetary powers granted to individual decision makers;</li> <li>- it allows for daily, weekly and monthly monitoring of cash available in the budget (revenues and expenditures);</li> <li>- it allows for comparing the actual state with its forecasts;</li> <li>- it is clear and relatively simple in technical terms;</li> <li>- it does not involve subjective judgment nor does it contain any estimates.</li> </ul>	<ul style="list-style-type: none"> <li>- omitting operations which do not bring cash flow;</li> <li>- disregarding the effect on the budget outturn of the following elements; late payments unpaid by the end of the year; securities transferred free of charge, forgiven loans granted from the budget;</li> <li>- taking advantage of the above omissions, one can manipulate the real budget deficit;</li> <li>- it is possible to manipulate the cash balance by delaying or accelerating payments;</li> <li>- it is not possible to create provisions for liabilities and receivables;</li> <li>- it fails to provide transparent information on the way public funds are used and better quality information which would allow the public to analyze how the public sector units manage resources and what goals are</li> </ul>



SELECTED PROBLEMS AND DEVELOPMENT PROSPECTS OF LOCAL GOVERNMENT UNITS' ACCOUNTING

		<p>achieved by spending those resources;</p> <ul style="list-style-type: none"> <li>- it fails to inform the public in greater detail about the public sector units' debt;</li> <li>- no clear information for the banks for assessing the units' creditworthiness;</li> <li>- it fails to provide for active management and control of the resources by all types of costs;</li> <li>- it fails to enable one to account for the full cost of an operation and the cost of using up assets for the purpose of providing services because it is very infrequent that the full cost of a service provided in the period concerned is equal to the cash spent during the same period;</li> <li>- it limits the application of commonly accepted methods and techniques of analysis, e.g. comparative analysis between the public sector units and a private sector entity engaged in the similar activity.</li> </ul>
Accrual	<ul style="list-style-type: none"> <li>- analytical picture of accounting records;</li> <li>- full picture of assets and liabilities;</li> <li>- minimized errors for payments made to beneficiaries;</li> <li>- a long-term perspective in financial reporting;</li> <li>- effective management and decision-making process on account of better information;</li> <li>- increased control effectiveness thanks to clear and consistent records;</li> <li>- tighter political control thanks to gaining better understanding of the financial effects of the policy conducted.</li> </ul>	<ul style="list-style-type: none"> <li>- no possibility of using directly in the public sector the accrual method applied in the private sector because the public sector features specific elements such as, e.g. infrastructure assets, social security schemes;</li> <li>- it is inconsistent with the cash-based budgeting;</li> <li>- it may lead to showing positive financial results before it is factually realized;</li> <li>- negative financial result may exceed the result produced on the basis of the cash-method.</li> </ul>

Source: self-reported data based on: (EU's new accounting system 2008 :1); (Winiarska, Kaczurak-Kozak, 2013: 44-46); (PwC, Coexistence of accrual and cash accounting, What is accrual accounting - after: Kaczmarek, 2009: 112-113); (Zysnarska, 2010: 39).

Its availability, being linked to the budget, technical simplicity are all the elements that support the use of the cash method, yet it is weighted down by the fact that the budget outturn may be manipulated, there is no information needed by the public on the effects produced by the public resource management, no insight as to the actual debt and no data necessary for the modern management of the public sector entities' finances. The accrual method eliminates the drawbacks of the cash method to a significant extent, yet it cannot be employed in certain specific

areas of budget accounting, while its implementation involves considerable costs, for example, the valuation costs, expenditures in terms of IT systems, training, etc.

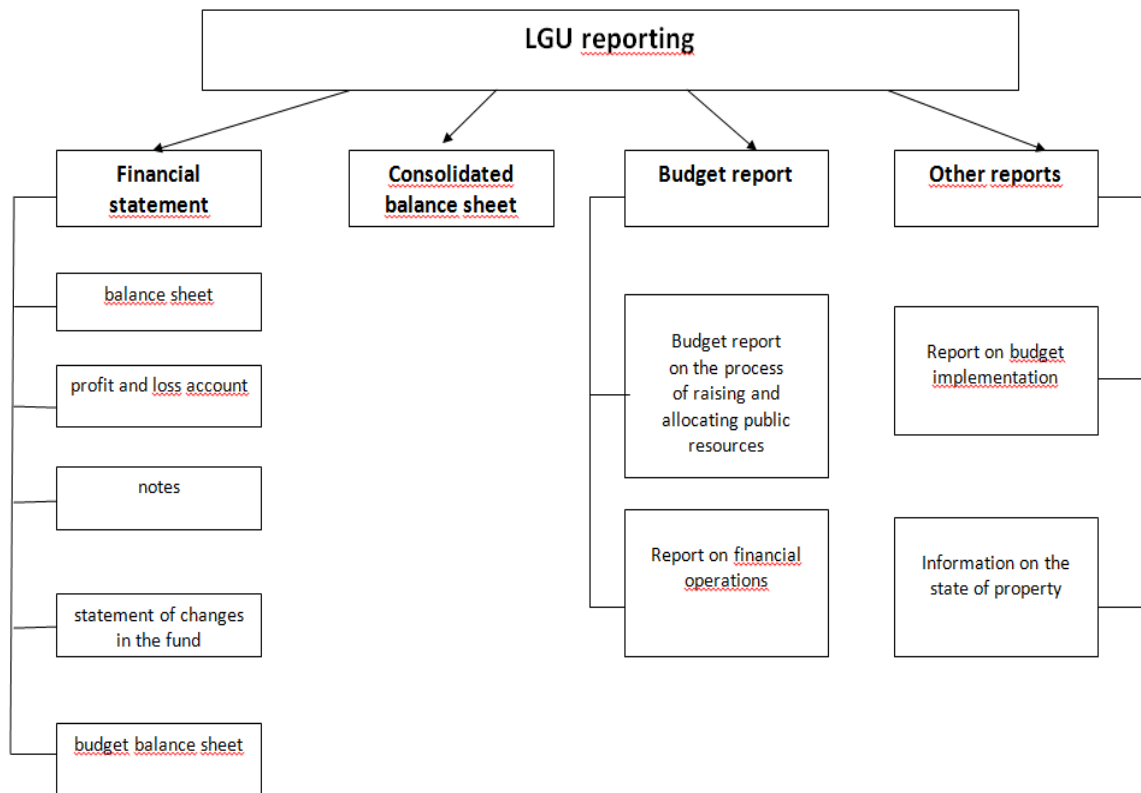
During the implementation of modern public management (*New Public Management* – NPM) focusing on the management displaying greater responsibility, cost-effective use of resources with the possibility of measuring the effects of the actions performed and comparing them with the standards, the budget accounting system should make it possible to track cash movements as well as the implementation of those tasks for which particular resources were given. From this point of view, the global trend to be observed in the budget accounting development is a shift away from the cash towards the accrual principle. Among the 40 International Public Sector Accounting Standards (IPSAS), only one is devoted to the cash method. The global financial crisis of 2007-2008 brought home the need to standardize budget accounting also in the European Union with this process being started by the EU authorities in 2011. Based on the studies carried out in 2012 on the suitability of IPSAS for the EU, the EC “affirmed the need for uniform accrual standards of accounting in the public sector across the EU; however, it noted that although IPSAS could not be those standards, they still could form a reference framework for EPSAS” (Nowak, 2015: 153). In 2014, commissioned by the European Commission, PwC estimated the costs and advantages of the EPSAS project, stating that at the cost of 0.009-0.053% of the total GDP of the EU countries (which represents EUR 2.35-13.58 per EU citizen, respectively), depending on the variant, their governments would gain “an exceptional opportunity to implement harmonized and reliable accounting solutions which will bring about financial reporting that is of high quality, transparent, credible and comparable, thus strengthening the accountability and decision preparation, both on the macro-level and that of entities” (PwC, 2014: 4, 86-87). According to the schedule of drawing up and implementing EPSAS, the system should be fully operational in 2020-2021. Implementing the EPSAS framework in Poland, relevant legal and administrative steps have been made to draw up the government’s balance sheet for 2018. In its “Proposals of the budget system reform” the Ministry of Finance emphasizes that “aligning the Polish rules on public accounting with the international standards requires a well-thought out concept and prudent implementation. In particular, the process of expanding the accrual principle should be preceded by an in-depth analysis of the needs and potential benefits in relation to the estimated costs” (the Ministry of Finance, 2016: 45). During the transitional period, a so called twin-track system will be operating in the majority

of the EU countries, including Poland, which consists in the accrual accounting coexisting with the cash accounting, allowing for a concurrent analysis of assets and obligations and real needs in terms of public funds.

### 3.2. LGU reporting

Another problem of the budgetary accounting is that LGU reporting is complex and multifaceted. It consists of the following elements: financial statement, consolidated balance sheet, budget report and other reports drawn up by the LGU management board (see Fig. 1).

**Fig. 1. The system of LGU reporting**



Source: self-reported data.

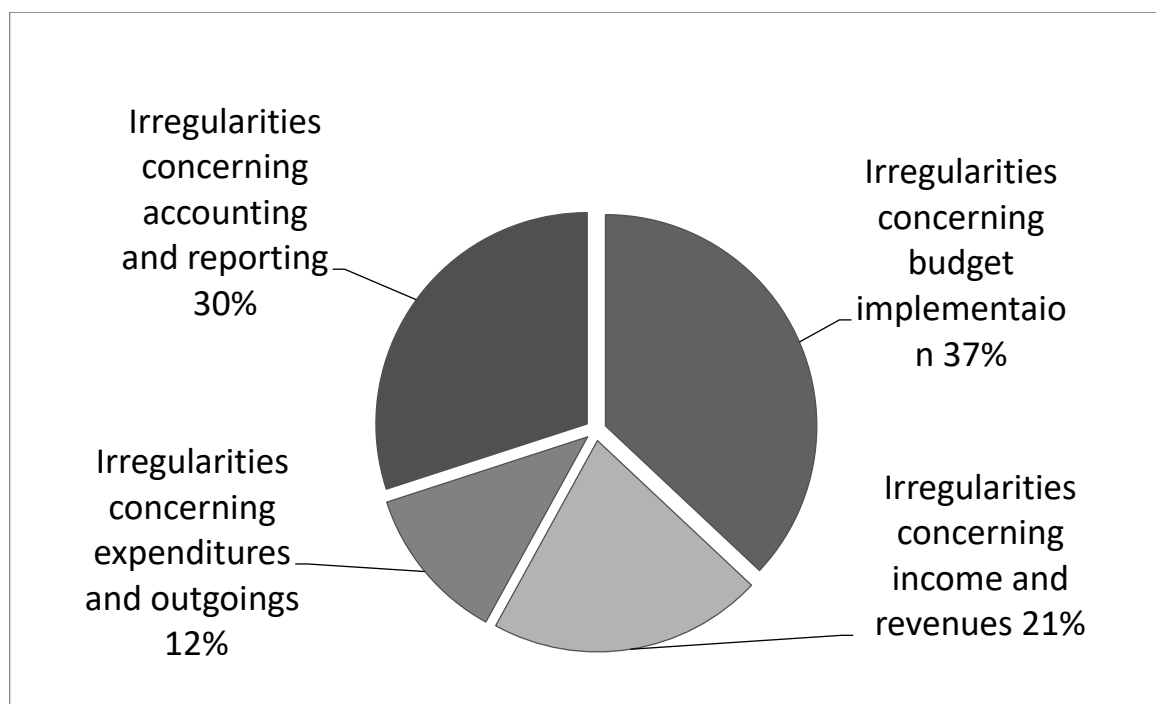
The individual elements of the LGU reporting system differ in a variety of aspects. The financial statement and consolidated balance sheet drawn up in this way at the date of closing accounts (usually for the financial year) while presenting the data on assets and liabilities,

revenues and costs, financial result, the unit's funds, goodwill, minority shareholding, are based on the accrual method, taking into account other principles indicated under UoR (the principle of proportionality of revenues and costs, the continuity principle, the principle of prudent valuation, the materiality principle, no-offset principle). The budget reports on income, revenues, expenditures, liabilities and commitments, budget outturn, guarantees and sureties are based on the following principles: cash, accrual, openness and transparency of public finances for the following periods: monthly (Rb-27S, Rb-28S), quarterly (Rb-NDS, Rb-27ZZ, Rb-50, Rb-30S, Rb-34S, Rb-28NWS), semi-annual (Rb-28NWS) and annual (Rb-27S, Rb-28S, Rb-ST, Rb-PDP). Other reports prepared by the LGU's board describe budget revenues and expenditures according to the budget statute, the progress made in multi-year programs and the state of property employing the principle of cash, and that of openness and transparency of public finance for semi-annual and annual periods. This variety of methods, forms and timeframes for drawing up LGU reports not only consumes time, human and information resources, hindering management but also, as some authors believe, "brings chaos into the process of public finance management" (Winiarska and Kaczurak-Kozak, 2013: 39). Only financial statements are interlinked (through the net financial result and the unit's fund), thereby forming a whole. The other reports do not have such links. One could agree with the description that the LGU reporting system is "internally inconsistent, yet its individual components deliver structured data on the unit's financial situation and that of its assets, on the budget implementation and the property state, while taking into account all possible property-based links with other entities" (Adamek-Hyska, 2015: 210). The broader implementation of the accrual method and the EPSAS into the budgetary accounting will foster greater internal consistency of the LGU reporting, thus contributing to saving in terms of time and money, as well as improving the management (see point 2.1). With the financial statement complemented by "Notes" since 2018, it will be possible for the data, which in the past used to be dispersed across different elements of the statement, to be integrated, which will allow for comprehensive assessment of the LGU accounting policy and for providing more transparent information for those in charge of the management.

### **3.3. Control and supervision in LGU budget accounting**

Another problem of LGU budget accounting is the organization of control in local self-government units themselves and external supervision exercised over LGUs.

One should define at the outset the differences between the concepts of “control” and “supervision.” According to the Constitutional Tribunal, “supervision is to be understood as specific procedures conferring the right on the relevant government bodies equipped with adequate competences to examine the facts as well as to correct the work of the supervised body” (cited after Storczyński, 2006: 47). Thus, it was found that “supervision is closely related to control, with supervision, however, being of a wider scope, for the right to control always stems from supervision, yet not all rights to control stem from supervision” (Storczyński, 2006: 48). Unlike the supervisory bodies, the controlling bodies may not intervene in the activity of the entities that are controlled. Control which is both the function of accounting and management, allows for verifying whether the result of performance conforms to the objectives set and whether the use of material and financial resources has been to a maximum extent so as to achieve optimal effectiveness. According to the category of where the entity conducting control is situated – control is divided into external and internal. As already shown in Table 2, supervision, including the external control of LGU performed under this supervision, is exercised by Regional Audit Chambers (RIO) and the Supreme Audit Chamber (NIK) (taking into account the requirements in terms of legality, reliability and cost-effectiveness). As required by their duties, the treasurer (LGU chief accountant), head of the village, members of the executive board of poviats (administrative districts) or a voivodeship exercise the functional internal control of LGU, while the internal institutional control is exercised by the LGU’s decision-making body. Under the comprehensive control over the LGU financial management, RIO inspectors examine, inter alia, how the internal control operates, how the accounting books and inventory are kept, the drawing up of financial and budget statements, the implementation of budget revenues and budget expenditures, the managing of municipal property, investment expenditures, public procurement, the implementation of tasks delegated and entrusted to LGUs, LGU financial settlements, LGU settling financial accounts with its organizational units, etc. RIOs conduct different types of control, for example, in 2016 the Wrocław RIO performed 46 comprehensive controls, 57 problem-based controls and 4 checks (Activity report, 2017: 1-3). In 2016 RIOs carried out a total of 1299 controls across Poland which found over 14 thousand irregularities at a level similar to that from the previous years (Finances with Error, 2017). The structure of irregularities found by RIO inspectors is presented in Fig. 2.

**Fig. 2. The structure of irregularities found by RIO inspectors in the year 2016**

Source: self-reported data based on Finances with Error 2017.

According to the report of the National Council of Regional Audit Chambers (KR RIO) on the RIO work and the LGU budget implementation for 2016, the areas where irregularities were most likely to be found covered budget implementation, accounting and reporting. This set of areas is not incidental as these are interlinked branches – irregularities in accounting will not allow for detecting deficiencies on time while implementing the budget, which once again stresses the need to improve budgetary accounting with a view to providing better support for LGU management.

Another external body supervising LGUs is NIK. In the course of an audit “Correctness of accounts and financial statements in selected budgetary units” the Supreme Audit Chamber found that among 14 central government and local government budgetary units which were examined none had financial statements presenting reliably and clearly the picture of the units’ situation in terms of their finances and assets, which resulted not only from the errors made while drawing up the statements but also from the irregularities detected in keeping the accounts and in organizing the accounting system. Some of the conclusions drawn by NIK inspectors were as follows:

- the budget units in question fail to attach adequate importance to accounting that goes beyond the needs of budgetary reporting;
- the mechanisms established for the management control failed to address the risk of irregularities in such areas as keeping the books of accounts and drawing up statements;
- the cash balance in the balance sheet did not reflect the actual balance as the result of subordinating accounting to the restrictions of budgetary reporting;
- heads of the units used the financial statements in a limited way, mainly for statistical purposes, failing to utilize the potential existing in those documents. Summing up, NIK concluded that considering the scale and type of irregularities found, the financial statements drawn up by the units could not provide an effective tool for managing the unit, as the decisions made based on those statements would carry too high risk. According to NIK, for utilizing the information included in the financial statements to its full extent, one has to improve its quality (NIK, 2015: 12-20).

The LGU internal control has an elaborated structure which is comprised of direct internal control, internal audit and management control (see Table 2). This structure is the result of the specific nature of functions exercised by the control carried out in the public sector finance; the control is to support management, be of assistance in solving problems, adapting to the environment, avoiding past mistakes in the future, optimizing the costs of implementing the development strategy (as it is done in commercial enterprises), and, first and foremost, to ensure that public funds are used in the most economic way. Internal control and internal audit are carried out in a continuous manner by usually separate LGU organizational cells with the difference being that internal audit is systemic in its nature, examining not only the financial area but also other areas of the LGU operations, including the effectiveness of management control systems, and it has an advisory role to bring added value and to make the unit's functioning more efficient based on the principle of continuous improvement. The management control, which supplanted the financial control that was in place until 2009, is to ensure that LGU's aims and tasks are implemented in a manner that is compliant with law, efficient, cost-effective and within set deadlines. It should be adequate, efficient and effective, ensuring, inter alia. risk management and that the principles of ethical behaviors are adhered to. In the optimal variant, management control should be carried out by both the leadership and other employees of the units. These are the formal requirements, yet in practice the implementation of the management control

encounters various obstacles (in terms of information, competencies, training, etc.) and is not always at the level required (see the post-control conclusions made by NIK).

### **3.4. Activity-based accounting in LGUs**

The emergence of the concept of activity-based accounting is associated with activity-based budgeting within the framework of the New Public Management strategy. The primary function of activity-based accounting is to provide information for budgeting by activities. Under this function, activity-based accounting should ensure that in terms of the activities to be performed, all (direct and indirect) costs (expenditures) of sub-tasks and actions are specified, it should facilitate accounting for the extent to which tasks have been completed and provide information on their progress in the form of periodic reporting. What is required for this to happen is combining the methods and techniques of budgetary accounting, cost accounting (e.g. the function of expense, full and variable cost accounting) and management accounting (mainly activity-based costs), including the analysis of costs and performance measurement.

For the activity-based accounting to be effective in LGUs, it is important to link the budgetary classification with the task classification in such a way as to allow specific tasks to be clearly associated with the relevant budgetary position each time upon entering data to the IT system. For the activity-based accounting and analysis what is also of major importance is the breakdown of activities into content-based activities relating to direct presentation of public services and supporting tasks (e.g. book keeping, building maintenance, IT, audit, control, etc.).

Activity-based accounting can be carried out, inter alia, under the following methods of organizing accountancy: expanding the analytics of the accounts already in place; mixed accountancy in cost accounts by functions (grouping 5) and accounts of grouping 9 (see account 990 “Financial plan for budgetary expenditure by activities”); establishing multidimensional accounts. The expansion of analytics in activity-based accountancy can unfold according to the analytical tree format: control account → task number → action number → budgetary classification chapter → section → type of benefit. We can come across this kind of expansion, for example, in the urban commune of Poznań; 130-KO/ZSI/01- GWSMK-75023-4210-001, where:

130 – control account “The unit’s current account ,”



KO/ZSI/01- task acronym – action 1 under the implementation of ZSI task (IT System Mangement) of KO organizational cell,

GWSMK – (Commune-Own-City's Own Funds) – the commune's own task.

75023 – what is the budgetary classification from which the task is performed,

4210-001 – task specification (purchase of specialized periodicals and literature).

In this urban commune, for accounting for direct task costs for the purpose of specifying the full costs of the task the extension of the accounts of grouping 5 was proposed according to cost objects as shown below (General Rules on Accounting Records, 2015: 9, 13):

500- cost accounting by divisions (analytics by divisions),

501 – buildings and facilities, including: 501-01 – building 01, 501-02 – building 02, etc.

502- transport, 503 – printing , 504 – IT, 505 – City districts (analytics by districts), 506 – infrastructure.

While using advanced IT systems based on SAP platform for accounting records the data referring, inter alia, to tasks, are recorded in an auxiliary financial module (FM- budgetary accounting), thereby creating multidimensional records. Multidimensional expenditure accounting in the SAP 94 system takes into account financial items according to the sections of the budgetary classification; budgetary programs by the activities of the activity-based budget; funds as sources of financing expenses allowing for identifying events in terms of financial statement and reporting; functional areas by the chapters of the budgetary classification. For instance, budgetary account assignment in FM SAP module in the Wrocław City Office sets out the following: financial item (division, chapter, section and the expense analytics); financial position (operator); functional area (finance sources – e.g. commune and poviats funds, entrusted, delegated, own funds, etc.); budgetary program (task).

#### **4. Conclusions**

The public finance sector operates in a very specific way which is reflected in LGU accounting – among other things, it is the multitude of legal acts regulating the LGU accounting, the scope it covers, the specific features of asset valuation and conducting inventory, unique reporting, external supervision and complex control system. The system thus complicated is not

altogether effective and cannot represent an adequate source of information for modern management of public sector units unless it solves its problems.

One of the problems of LGU accounting is the transition from the cash method to accrual method under the EPSAS implementation. This process has already been set in motion but requires “a well-thought out concept and prudent implementation,” as the Ministry of Finance is right to emphasise (Ministry of Finance, 2016: 45). Therefore, it is to be expected that during this time Poland will see a twin-track system in the public sector accounting.

In its current state, LGU reporting is complicated and internally inconsistent, which hinders delivering data for managing entities of the public sector. For this reason the changes in the reporting planned by the Ministry of Finance are well-founded in that they focus on making reporting consistent, more simplified and harmonized (with respect to individual entities engaged in the public finance sector as well as common principles of budgetary and financial accounting).

Every year the external supervision bodies and LGU internal control find numerous deficiencies in terms of the accounting system organization, keeping the books of accounts and drawing up reports. Failing to detect errors effectively and without being able to prevent successfully potential irregularities in budgetary accounting the LGUs are incapable of performing their duties in full.

The implementation of activity-based budgeting under modern management has posed new challenges for public finance accountancy. The activity-based accounting seeks to cope with these demands by combining the methods and techniques stemming from cost accounting and management accounting, as well as by applying a variety of measures in accounting records (such as, inter alia, analytical development of accounts under grouping (4 and 5) or by implementing multidimensional accounting entries).

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